The ultimate battle in the sky – reinventing the long-haul travel

Arthur D. Little explores the future development of long-haul air travel

Since the mid 2000s the air-transport industry has been in an era of hyper-competition. Medium-haul has been irreversibly disrupted, and the sector has become a mass-market industry. Now airlines are preparing for the next battle in the sky: the fight for the long-haul traveler. With lower regulatory barriers and the latest long-haul aircrafts delivering on their promises, new business models are emerging, from "long-haul, low-cost" (LHLC) to the revisited "ultra-long range". Therefore, no one seems immune: neither legacy airlines around the world, nor the mighty Gulf carriers. All may have to rethink their strategies.

Winning the long-haul battle is key to compete in the up-coming "hyper-consolidation" era

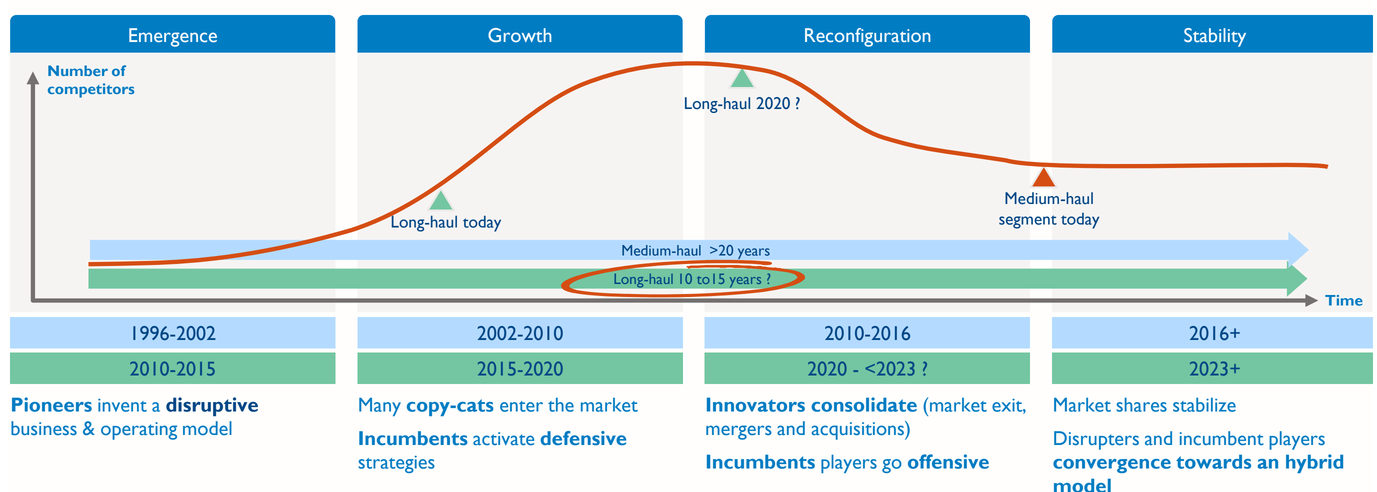
The low-cost model is finally emerging for long-haul flights, and even still being in its infancy, it is raising the question of the economic sustainability and the future of legacy carriers.

Indeed, we observe that the disruption cycle in long-haul travel will be much shorter than in the medium-haul segment where it took 20 years to reshape the industry. Airlines must therefore act quickly and strongly in transforming and positioning themselves to reinvent the long-haul travel experience and its associated business and operating model.

Also, after the struggle for the medium-haul market, the outcome of this "ultimate battle in the sky" will position airlines when it comes to the next era in the industry post the "hyper-competition" era, i.e. the "hyper-consolidation" era.

Keep on succeeding in the long-haul segment will thus enable some airlines to become global industry shapers, some could rather be "hunted pearls" – that will be acquired and maybe disappear, but surely maximize the return for their shareholders thanks to niche leadership or a unique combination of strengths – and most of airlines could become "valueless/ commoditized".

Disruption cycle in medium & long-haul air travel



Long-haul low-cost: new life for an old concept

Examples of LHLC carriers date back to 1948, when Loftleidir offered no-frills flights from Reykjavik to New York, and 1977, when Laker Airways entered the London-to-New York route. More recent attempts to develop the market have been made by Zoom Airlines (Canada) and Oasis Hong Kong Airlines, both of which ceased operations in the late 2000s.

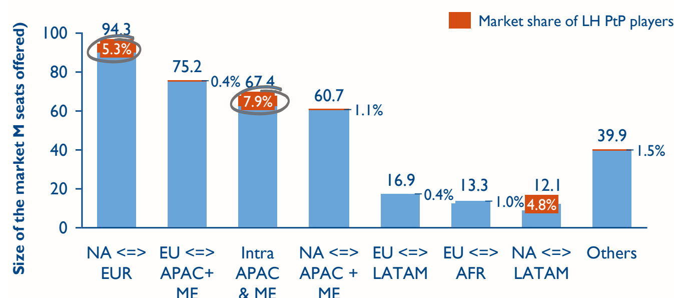
Since the early 2010s, LHLC carriers have however entered every major inter- and intra-continental market. Drivers for expansion were the maturity of the short- and medium-haul models, as well as technological advances in terms of fuel efficiencies and operating costs brought by new generation of aircrafts – the B787, the A350 and the revamped A330.

Long-haul, low-cost routes in 2016

Source: SRS analyzer, Arthur D. Little; ASC = available seat capacity in 2016

Today, the 19 LHLC airlines represent only 3% of the total long-haul market, operating 50 scheduled routes. But their offerings tripled for the period 2010–2016, going from 3.7 to 12.7 million in available seating capacity, with focus on gaining critical mass in the existing-routes portfolio: in 2016, new routes thus represented only 4% of a 28% total capacity increase. Most destinations are within approximately eight hours' flight duration, the "sweet spot" for optimal asset utilization and lowest cost.

LHLC penetration rate in 2016 (major routes)



Source: SRS analyzer, Arthur D. Little analysis

However with ongoing aircraft deliveries and limits on penetration rates for existing routes, we expect expansion on new routes: indeed (a) Europe ⇔ APAC and the Middle East, and (b) APAC and the Middle East ⇔ North America are showing similar passenger-traffic volumes and are currently more unexploited by long-haul new entrants than the already penetrated North America ⇔ Europe, the intra-APAC and the Middle East markets.

Boosting revenues is the secret key to the success of the long-haul, low-cost model

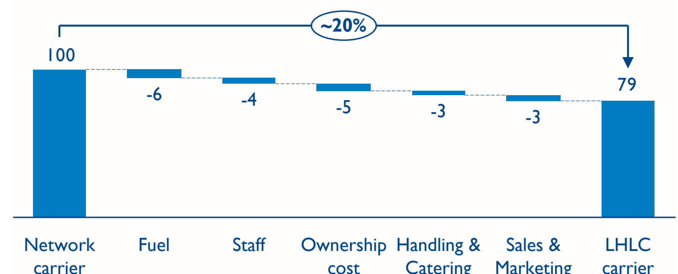
Developing a viable business model for long-haul, low-cost flights is challenging. Our analysis shows that long-haul, low-cost airlines can maintain the same margins as their network peers, even with a 20% decrease in revenues per flight. But LHLC carriers are flying in thin air, as this -20% might not be powerful enough to grab market shares compared to the -50% that medium-haul, low-cost carriers (LCCs) have achieved.

Competing with the lowest cost base possible is, of course, a pre-requisite, however maximizing revenues per seat is the real key to enduring success.

Fixing the basics on the cost side: We have identified five areas in which low-cost carriers could exploit a significant cost advantage. Overall, the operating economics associated with long-haul flights present a potential of ~20% cost advantage compared to network carriers' cost structure. This comes from:

- Consuming up to 20% less fuel than airlines flying old-generation aircrafts, thus gaining an overall cost advantage of around 6% for LHLC carriers
- Up to 25% savings would come from reduced cabin crew, more productive cockpit crew and lower employer contribution
- Going from an average of 12h up to 16–18h per aircraft, thanks to a point-to-point network strategy
- Limited catering and in-flight services (handling and airport charges would be similar when serving same airports)
- Lower spending on sales and marketing, with typical low-cost carriers selling almost 80% of their tickets directly, and more intensively leveraging cheaper digital marketing

LHLC cost per flight advantage vs. legacies



Source: Arthur D. Little analysis

Winning the battle on the revenue side: LHLC carriers leverage on three major drivers: i) cabin-seat density, ii) unit revenue per seat (fare price and ancillary revenues) and iii) cabin mix between seat categories (economy, premium economy and business).

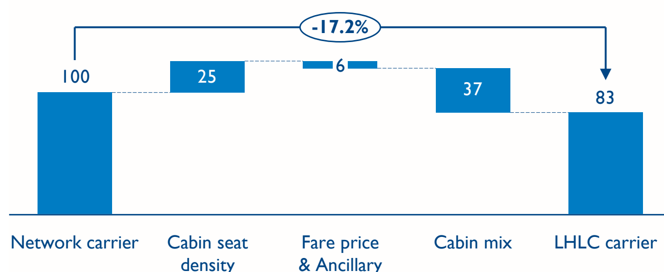
Higher seating density can provide a 25% revenue advantage compared to network carriers for any given flight. AirAsia X, with 377 seats on an A330-300 (compared to Malaysian Airlines' 290-seat configuration), and Norwegian, with 291 seats on a

787-8 (compared to British Airways' 214-seat configuration), are striking examples of the ability to increase cabin capacity.

However, in order to attract passengers and deliver on their promises, LHLC carriers are indeed doomed to offering significantly lower fares than legacy carriers, typically -25% for a comparable seat category.

Another challenge for low-cost carriers is the disadvantage of their cabin mix vs. that of legacies. Indeed, premium traffic may account for only 10–20% of network airlines passengers, but represent up to 40% of revenues on long-haul flights.

LHLC revenue per flight disadvantage vs. legacies



Source: Arthur D. Little analysis

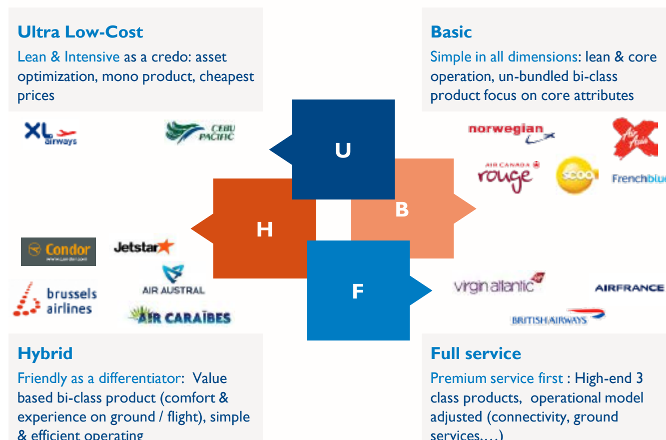
Overall, the revenue advantage that a network carrier could expect from its ability to drive premium traffic and operate a "premium cabin mix" could be as high as 35–40% per flight.

Strong, innovation-driven sales of ancillary products are thus required and heavily implemented to reduce the gap between network carriers and low-cost competitors to as low as 5–10%. A notable example is Air Asia X opting for more than $35 of additional revenues per passenger, derived from dynamic baggage pricing, in-flight products and transit services.

Cargo is also a robust contributor to the business of long-haul, low-cost airlines, with players like AirAsia X, Norwegian, Scoot or Eurowings offering their belly capacities, sometimes relying on the cargo organization of their mother-airline.

New long-haul models have not yet stabilized

Emerging long-haul models

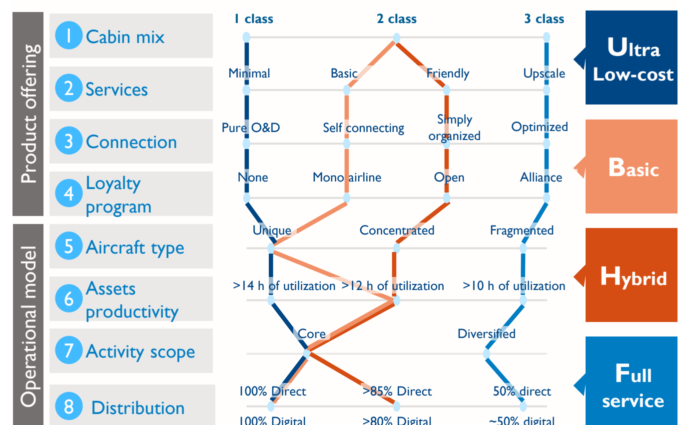


Overall, the competitive landscape will be structured around four strategic models that will fiercely confront each other by achieving different operating model and product strategies.

In terms of **network structure**, there are alternative models emerging. The initial standpoint for network strategies of low-cost airlines is to focus on point-to-point (Air Canada Rouge, XL Airways). However, some LHLC airlines rely on their own feeding capabilities (Air Asia X, Norwegian, WOW, etc.); others establish alliances to leverage specialization between short- and medium-haul and long-haul partners, replicating the code-sharing partnerships between full-service providers (e.g., Scoot, a member of Value Alliance). A virtual hub is another plausible option, in which a third party proposes either self-connecting flights or connecting services, for example, at Gatwick, Milan or Delhi airports.

Another pillar for successful LHLC and maximization of revenues is **product differentiation** and quality of service.

Main features of strategic models in long-haul



Today LHLC carriers are rethinking the whole customer experience to provide a new, fresh and appealing product for travelers. If most low-cost players do not yet rival legacy competitors in terms of seating comfort and in-flight catering, they can deliver more content-rich in-flight entertainment, including internet access and "bring-your-own-device" strategies. They can also rival most basic legacy carriers.

Ultra-long-haul: a retaliation weapon against the long-haul "low cost"/ "low fare" Gulf carriers

Next-gen aircrafts are now triggering another reinvention of long-haul travel by enabling more competitive ultra-long-range flights. Singapore Airlines has already ordered seven A350-900ULR for its future New York operations. Qantas also recently expressed interest in reopening routes to Europe, thus bypassing its JV agreement with Emirates. ULR aircrafts are thus a double-sided sword: ULR flights can indeed attract travelers looking for time-efficient solutions, and it would naturally bypass direct competition, in particular from Middle Eastern airlines and from home-based LHLC airlines. After routes from ASEAN to the

US east coast or the Kangaroo Route, routes to LATAM from Northern Asia, Europe and the Middle East or between Asia and Africa might follow.

Still, if aircraft economics are promising, on-board products and services might need to be reinvented for up to 19h flights.

Lean and agile best practices are must-have to play; a reinvented passenger experience will make the difference

After 2000–2010 saw a new form of medium-haul air transport become the "new normal," we will thus clearly see new forms of long-haul flights by 2020.

In order to be successful, new low-cost entrants should monitor several key factors, such as:

- Fine-tuning the commercial offering (e.g., price point vs. service level vs. inclusive/ à la carte features) if not able to capture high-value frequent business travelers, then to monetizing a unique and reinvented passenger experience
- Maximizing sales efficiency and brand impact, not de-prioritizing destination markets vs. home-market for marketing efforts
- Developing smart network planning to find the right balance between serving the market demand and optimizing both aircraft and crew utilization
- Quickly reaching a critical fleet size of >10 aircrafts to leverage economies of scales
- Implementing smart alliance schemes, including leveraging hubbing opportunities with internal or external partner airlines

For legacy players, the challenge in order to thrive in phase two of the era of hyper-competition is even bigger, as they need to:

- Create investment capability to accelerate fleet renewal as a key enabler for lower cost per seat and revamped cabins
- Leverage the full potential of their loyalty programs and brands to retain business travelers and re-inspire the economy class
- Rethink their offerings to keep segregated offers and boost ancillary sales pre- and in-flight
- Manage "co-opetition" with internal partner airlines and go beyond current schemes to promote the next generation of alliances

Overall, airlines that do not play with competitive cost bases through lean & agile culture and practices will be excluded from the game. Brand equity and passenger experience, pre-, in- and post-flight, in the air, and on the ground, will make the difference between churn and loyalty.

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